Singapore Management University
Institutional Knowledge at Singapore Management University

Knowledge@SMU | Office of Research & Tech Transfer

9-2011

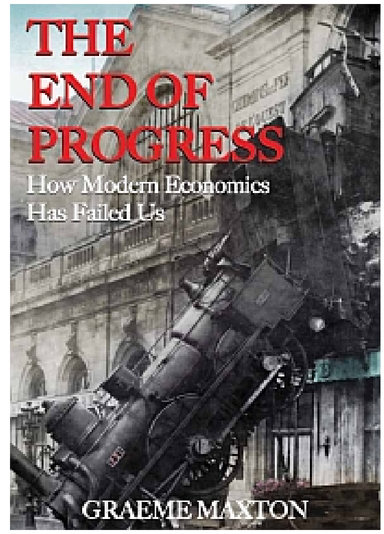
How the mindless growth mantra of modern economics is failing us

Knowledge@SMU

(http://knowledge.smu.edu.sg)

How the mindless growth mantra of modern economics is failing us

Published: September 06, 2011 in Knowledge@SMU



Just three years after the 2008 global financial crisis, the world wonders, yet again, if another global downturn might be looming.

Since the start of August, world stock markets have been falling sharply after Standard & Poor's credit downgrade of the United States and the burgeoning debt crisis in the euro zone.

"So far it's not as bad as 2008, but it could get much worse because the sovereign debt concerns are much more global than the subprime mortgage risk of 2008," Darrell Duffie, a professor of finance at Stanford and an expert on the banking system, told The New York Times.

The growth prospects of the global economy are deteriorating, recent economic data show. Indeed, Robert Zoellick, president of the World Bank, has warned that the global economy has entered what he called a "new and more dangerous phase".

In the US, unemployment hovers around 10 per cent despite the Federal Reserve cutting short-term interest rates to nearly zero and injecting more than US$2 trillion into the economy in two rounds of quantitative easing or inflating the money supply to stimulate growth.

In Europe, Greece, Ireland and Portugal have received bailouts to the tune of €380 billion (US$539 billion) since last year. Now, markets are worried that Italy and Spain, the third- and fourth-largest European economies, are next in line for further bailouts.

Doubts are also mounting that the European Financial Stability Facility – the euro zone's €440 billion (US$627.7 billion) bailout fund – is sufficient to shoulder Europe's debt woes.

That in turn has led to a marked shift in perception about the risks in investing in developed and developing economies, Bob Prince, co-chief investment officer of fund manager Bridgewater Associates, told the Financial Times.

"Emerging creditor countries are trading more like blue chips, the US is trading more like a country in decline and developed debtor countries that lack the ability to print money are trading worst of all," Prince said.

At the heart of all this misery lies modern economic thinking, which has trashed and distorted the principles and theories of Adam Smith, the father of modern economics, argues economist Graeme Maxton in his book, "The End of Progress: How Modern Economics Has Failed Us (http://endofprogress.com/)".

A regular contributor to The Economistand guest on CNBC and CNN, End of Progressexcoriates the political and economic focus of the world in the last 30 years, which, the author believes, has brought about environmental degradation, food shortages, the denudation of resources, and widening income inequalities.

The invisible hand?

In the two hundred years since the age of Enlightenment when Adam Smith transformed the way the world thinks about economics, Maxton says that mankind has forgotten that Smith's famous advocacy of the "invisible hand" of the market – free competition and open trade, and a minimum level of government interference – are also heavily underpinned by ideas of efficiency, balance and social justice. Smith saw fairness as being vital to all economic activities.

So while people should act freely, guided by the invisible hand, their actions should also be in the interests of social harmony. Over time, however, some of these principles were gradually eroded and even ignored.

Maxton neatly summarises how that has happened by explaining how thinking in economics has evolved since the first World War, as the lack of regulation and too much of it caused wild economic swings.

Today's freewheeling take on laissez-faire economics began in the late 1970s, when a new generation of economists argued that state control was constraining economic development in many countries due to inefficient bureaucracies and frequent strikes.

Economists from the Chicago School began calling for minimum government intervention and greater market freedoms. This subsequently led to the emergence of the Washington consensus – a group of economists, politicians and journalists who rallied behind these ideas – which were then embraced by the International Monetary Fund and the World Bank.

As modern economic thinking swung to the other extreme of deregulation in reaction to state control, the mantra became, "the markets are always right, governments are always wrong", Maxton noted.

With much of the world in thrall to free marketers, the last three decades saw the fastest period of global economic growth, which liberalised trade and opened up new markets in India and China.

It also resulted in greater economic volatility, such as the information technology boom and bust in the late 1990s, and spikes in food and resource commodity prices. The under-regulation of financial markets led to the proliferation of financial speculation, high consumer debt-driven spending and the largest debt bubble that culminated in the 2008 global financial crisis.

"The rise of wealth and pace of growth were not natural and we knew it," Maxton wrote. "But most of us chose instead the path of blindness, of personal short-term gain rather than long-term social responsibility."

Simply put, modern economics thinking has simplified ideas about individuality and unrestrained market freedom. That has led us to undervalue food and resource commodities, accelerating the pace and amount we consume.

"Modern economic thinking has given us false goals, demanding growth for its own sake, encouraging a mania for consumption that requires the planet to be laid waste, exploited for our convenience," he continued.

"We have also created a world that is unstable. In many places, for the first time in centuries, we face falling life expectancies. We risk battles about food, water and oil as resources decline. We face strife over political ideologies and the rise of nationalism."

Consumed with consumption

Besides explaining how the world became the way it is today in a clear and easy to understand manner, Maxton urges readers to rethink what constitutes economic progress, arguing that our current pace of consumption is unsustainable - even suicidal.

To that end, he offered up four main ideas on how the world needs to be reshaped. These ideas are premised on classical economic philosophy, based on concepts of equality, fairness and value, and not undeserved profit and selfishness.

First, Western economies have to shrink. Instead of stimulating their way to economic growth, the West and Japan should accept lower economic growth in the form of government cutbacks, reduced consumer spending, and tax hikes, until the economies become viable.

Acknowledging that such changes would be massive and difficult with no guarantees that they will work, Maxton says the West needs to accept that the level of economic activity in the past was neither normal nor sustainable.

Second, to reduce environmental problems due to the over-consumption of food and resource commodities, they should be priced properly, which necessitates raising taxes and prices, and to even discontinue the practices of corporate environmental polluters by levying heavy penalties.

Maxton realises, of course, that this is easier said than done. "The trouble is how to implement such ideas globally and how to manage the effects," he wrote. "As the price of many items would rise, such measures would penalise the poor more than the rich. There is also a risk that the governments of many developing nations would see such laws as unfair, limiting their right or ability to industrialise, or develop economically. Such hurdles, however, should not stop us (from) trying."

Third, companies should make fair amounts of profits, and to do so in a socially responsible way.

"(Companies) should not be allowed to make excessive profits long term or act against the needs of society, by increasing income inequality or selling goods that make us ill, for example," Maxton wrote.

Comparing the 2009 financial results of carmaker Volkswagen and investment bank Goldman Sachs, Maxton noted that Volkswagen made a profit of US$1.2 billion or less than one per cent of its revenue of US$137 billion. Almost US$29 billion of the revenue generated added value to society in the form of employment, dividends to investors, and taxes.

In contrast, Goldman Sachs made a profit of US$13.4 billion despite receiving US$10 billion of US government aid in the first three months of 2009. That's 10 times the profit of the carmaker for the entire year.

“Is it fair for a bank to make ten times the profit of a car manufacturer when that excess return comes not from supporting economic growth, or financing business development, but from gambling?” he asserted.

Lastly, Maxton believes that markets need “Goldilocks management”; that they should be regulated and operate according to principles of openness and fairness.

To do that, he proposed the use of Germany’s *Ordnungspolitik*, which roughly translates to “the policies needed to keep the system in balance”. In his view, *Ordnungspolitik* is a political and economic philosophy that has sustained one of the most successful, strong and stable economies in the last 50 years.

“*Ordnungspolitik* offers a middle road between the two extremist political ideologies of the twentieth century - capitalism and communism. Both failed because they lead to a concentration of power in distant and unaccountable institutions,” Maxton argued.

“In the communist system, power became too concentrated in government, in the hands of a few. In the free-market system, power became too concentrated in the private sector, in the hands of a small number of people running big companies and banks.”

A no-holds-barred critique of the global political and economic systems, End of Progressis bold, witty, and at times acerbic. Although relatively short in comparison to other usually weightier tomes that touch on the major challenges of our times, the book is a good primer for those who wish to examine the global economy from a more critical perspective. If nothing else, it’s well worth the time alone to acquaint oneself with the thinking of Adam Smith, the father of modern economics, and to learn how far we have diverged from his teachings.

back to top (#top)

back to top (#top)